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January 7, 1977

Letter Report 297

Honorable Mike Cullen
Chairman, and Members of the
Joint Legislative Audit Committee
925 L Street, Suite 750
Sacramento, California 95814

Dear Mr. Chairman and Members:

In response to a resolution of the Joint Legislative Audit Committee, we have examined certain fiscal operations of the Milpitas Unified School District (MUSD). This examination was conducted under the authority vested in the Auditor General by Section 10527 of the Government Code.

The MUSD in Santa Clara County has an average daily attendance of approximately 10,100 students. General Fund expenditures for the fiscal year ended June 30, 1976, were approximately \$13.5 million.

The Education Code places responsibility for the administration of school district financial affairs upon the Governing Board of School Districts. The Board must adopt and approve the annual budget and transfers among budget items. The Board must also approve all payments from school funds.

The scope of our work included a management review of district policy and procedures related to the following items:

- Student body funds
- Expenditures for instructional supplies
- Money raised by parent and student activities
- Purchase of electronic data processing equipment.

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The special nature of this review did not include an examination of financial statements of the district in accordance with generally accepted auditing standards. Accordingly, we do not express an opinion on the financial statements of the district.

In our judgment, the management of the Milpitas Unified School District (MUSD) has been generally effective in meeting its program objectives. However, we have concluded that the district business service office has not had the staff to adequately monitor and supervise the financial operations of the 15 schools. A breakdown in internal control procedures for student body funds was caused primarily by understaffing of the business office. The district has since strengthened these control procedures.

The MUSD Board of Education should seriously consider reestablishing the accounting officer position that was abolished—for cost-savings reasons—in September 1974. The heavy workload of the Assistant Superintendent for Business Services has made it difficult for him to be fully responsive to members of the Board of Education, to concerned citizens of the community, and to the day-to-day business and accounting operations.

It took the district approximately two years to correct the internal control weaknesses related to the student body funds. This delay further indicates that the business service office of the Milpitas Unified School District is understaffed.

Management Control of Student Body Funds

In November 1974, the accounting office informed the Assistant Superintendent for Business Services of a deficit in the student body fund for the Thomas Russell Junior High School. The District Superintendent hired a certified public accountant to review the records and internal control procedures relating to student body funds for the intermediate and high schools in the MUSD.

On April 21, 1975, the certified public accountant issued a letter to the district outlining a number of deficiencies in internal control and accounting procedures for student body funds. These deficiencies are described in Appendix A, page A-1, of this report.

A management letter from the certified public accountant was issued on May 9, 1975, to the Business Manager. This letter stated that for eight vendor invoices totaling \$6,678.20, purchase requisitions were prepared after the goods were delivered.

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Later, district accounting personnel found other invoices for unauthorized purchases, and these purchases increased the deficit to \$10,688.15. The deficit consisted of \$9,170.94 in student body funds and \$1,517.21 in General Fund budget items for the Thomas Russell Junior High School.

In a confidential report to the Board of Education, the District Superintendent presented four possible solutions for liquidating the debts incurred at Thomas Russell Junior High School. The four suggested solutions were:

1. The district could pay off the debt by the use of district reserve funds.
2. The vendors would be informed that the district would not pay the debts due to a lack of a formal commitment (possibly the district would be sued for the debt owed plus interest).
3. The Thomas Russell School Student Body, Parent Faculty Organization, and district would, based on some agreed to formula, pay off the debt under this plan. The district would pay off the total debt with an account being established to receive income due from the student body and parent organization.
4. The district would deduct, commencing with the year 1975-76, an amount of \$506.00 each year from Thomas Russell School's instructional supply and textbook budgets which would clear up the debt in three years. The district would pay off the total debt of \$1,517.21 and set up an accounts receivable for \$1,011.21.

For the outstanding debt of the student body of \$9,170.94, the student body of the school would be required to pay off \$1,834.00 each year beginning with the 1975-76 school year. Again, the district would pay off this debt and set up an accounts receivable to receive annual payments of the Thomas Russell School Student Body. It would be expected under this plan that the Thomas Russell Parent Faculty Organization could assist the student body in paying off this debt.

On December 2, 1975, the Board of Education authorized payments for the unauthorized expenditures at Thomas Russell Junior High School. The Board agreed to have the district reserve fund absorb the unauthorized expenditures.

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Action Taken to Resolve
Internal Control Deficiencies

On August 2, 1976, the Acting District Superintendent presented a student body accounting manual to the Board of Education for approval. This manual provides guidelines and procedures for the accounting of all student body activities. The manual was prepared by a certified public accountant, and it conforms to the State Department of Education, School Business Administration Publication No. 3, Accounting Procedures for Student Organizations.

In September 1976, the manual was distributed to all principals in the district school system. In a letter to the school principals and student council advisors, the Acting Superintendent recommended that each school establish a student body organization. The letter also described new district policy. Before processing student body purchase requisitions, the district will require the following:

- Principal's signature
- Advisor's signature
- Student's signature
- Date of Student Council meeting authorizing such expenditure.

In addition, funds deposited in the student body account will require student body approval prior to disbursement.

Monies Raised by Parent and Student
Activities Are Used by the District

Corrective action has been taken to prevent comingling of student body funds with non-student body funds. New instructions to school principals and their assistants detail step-by-step procedures for depositing and accounting for non-student body cash collections. These instructions include a list of non-student body activities.

In the past, student body and non-student body funds were comingled; comingling made it difficult, if not impossible, to accurately account for all funds. In the future, funds raised by Parent Faculty Clubs, Parent Teacher Associations, and other clubs with donations restricted for special purposes are required to be deposited in the General Fund and accounted for in special accounts.

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Management Control of Expenditures for
Instructional Material Supplies

The MUSD school budget control procedure is decentralized. Each school is assigned a budget based on the average daily enrollment. Each school principal is responsible for allocating the funds available to conduct the educational activities of the school. District management believes that the principal is the manager and that budgeting is a prime responsibility.

At the beginning of the school year, each principal submits a detailed budget, based on a district allocation, to the Assistant Superintendent for Business Services. This detailed budget is stored in the computer by account classifications. During the year, as expenditures are recorded, monthly reports are issued to each principal. These reports show the budgeted funds, expenditures incurred, and the unexpended balances.

This procedure also allows district management to effectively monitor the financial operations of each school on a monthly basis. Any budget deficiencies due to overexpenditure can be resolved before serious deficits develop.

Principals are allowed to transfer funds within a school budget. Without Board approval, funds may be transferred from one program to another (Art to Business Education, etc.). As long as no major expenditure category is exceeded (Books, Supplies and Equipment Replacement), fund transfers are allowed.

Transfers of funds between major expenditure categories and from contingency reserves are to be approved by the Board of Education in accordance with Section 20951 of the Education Code. In May or June of each year, the Board of Education adopts a resolution that allows the County Superintendent of Schools to: (1) pay obligations that exceed the amount budgeted in a major expenditure category and (2) transfer funds from the appropriation for contingencies to any expenditure category or between expenditure categories.

The certified public accountant retained by the Board assured us that budget transfers between expenditure categories and transfers from the contingency reserve are approved by the Board of Education.

Purchase of Electronic Data Processing Equipment

The MUSD has used a Burroughs 1500 ledger card accounting machine system since 1967. In 1971, the system was supplemented by a second accounting machine. Both student body accounting and business

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accounting needs of the district grew, and in 1975 some processing was done on several systems. The district was using a commercial service bureau, the County Office of Education, a rented computer, and the two "in-house" bookkeeping machines.

District management found that there were serious drawbacks to this fragmented accounting system. The primary drawbacks were:

- Data processing was excessively expensive
- The systems used were not integrated
- District accounting and reporting needs were not met
- District budget control needs were not met.

In March 1974, district management formed a data processing committee to determine the total needs of the district. The committee produced three alternatives to handling the district accounting work:

- Commercial service bureau
- Use of the County Office of Education EDP service
- In-house computer system.

Using a commercial service bureau was ruled out because it would violate the Education Code, which only allows the use of a commercial service for 90 days during peak load emergency situations.

Using the County Office of Education computer was considered feasible; however, the system was not immediately available and would not be completely operational for at least two years. The County Office of Education services would cost approximately \$48,000 annually and might not meet all of the district needs. The county EDP system was ruled out.

Installing an "in-house" computer was the most efficient alternative, but it was not cost effective for the size of the district. MUSD management, however, learned of an IBM 360 Model 20 computer in use by the Monterey Peninsula Unified School District. This computer was to be replaced in August 1975 and would be available for purchase. The price was quoted at \$50,000, or about one-third of the initial cost for this type of computer. In addition, the management of the Monterey Unified School District offered all of the available software, computer system documentation, and training in the use of both the hardware and software, at no additional cost.

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It was the opinion and recommendation of the data processing committee that the purchase of the IBM 360 computer from the Monterey Peninsula Unified School District was the best of the three alternatives.

The committee also recommended that the district accept the offers of two computer experts who volunteered to provide free programming services in converting the existing accounting system to the IBM 360 computer system. One of the experts is a former member of the MUSD Board of Education, and the other expert is a current Board member.

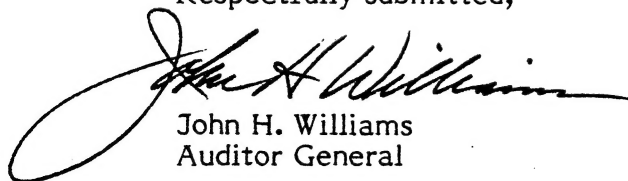
The MUSD Board of Education authorized the District Superintendent to bid on the IBM 360 Model 20 computer owned by the Monterey Peninsula Unified School District. The County Superintendent of Schools for Santa Clara County approved the contract for the purchase of this computer on June 27, 1975.

The computer was purchased in accordance with provisions of Section 16453 of the California Education Code. This code section allows a school district to purchase equipment from another school district without advertisement for, or receipt of, competitive bids. The acquisition cost of \$51,050 was paid with revenues from the sale of excess school land. Provisions of Section 16053 of the California Education Code allow the purchase of equipment from the proceeds of excess land sales.

The IBM 360 Model 20 computer was installed in the district office and became operational in mid-September 1975, when the perpetual stores inventory records were implemented. The budget and expenditure records for each of the 15 schools and district office operations were begun on July 1, 1976, the beginning of the 1976-77 school year.

Monthly budget and expenditure reports give the principals of each school an up-to-date report on the status of both student body and General Fund accounts. The reports also give district management the necessary data to control the budgets of all General Fund and student body fund accounts.

Respectfully submitted,



John H. Williams
Auditor General

Staff: Jerome Wentz

Attachments: Response to the Auditor General's Report
Appendix A--Summary of Deficiencies and Recommendations
Relating to Student Body Funds within the Milpitas
Unified School District

RESPONSE TO THE AUDITOR GENERAL'S REPORT

This report was discussed with administrative personnel of the Milpitas Unified School District on January 3, 1977. The Superintendent was in general agreement with the report and felt that a written response was not necessary.

SUMMARY OF DEFICIENCIES AND RECOMMENDATIONS
RELATING TO STUDENT BODY FUNDS WITHIN
THE MILPITAS UNIFIED SCHOOL DISTRICT

Prepared by C. G. Uhlenberg & Co.
Certified Public Accountants
April 21, 1975

1. The district does not have adequate written policies and procedures in effect at the present time to insure the safekeeping of student body fund assets. Specifically, we noted a lack of effective procedures in the following areas:
 - A. Cash receipts are not reconciled to inventory usage or to receipts issued to individuals. Without such controls, shortages in cash or inventory could occur without detection.
 - B. Deposits are not made on a daily basis. In some instances, cash receipts remain at the schools up to a week before being counted by the advisor responsible for the funds and appropriately receipted by the person preparing the deposits. During such times, a number of persons have access to the safe.
 - C. In some instances receipts are not deposited in tact. Undeposited and even uncounted funds have been used for direct cash disbursements. As a result, control over cash is weakened.
 - D. Procedures are not established for collection of funds due from returned checks and for redeposit of returned checks.
 - E. It was noted that purchase requisitions were prepared subsequent to receiving vendor invoices. As various individuals are independently ordering goods without authorization or in conjunction with budgetary controls, the student body cash balance is inadequate to pay currently due liabilities. This problem would be avoided through the proper use of purchase requisitions.
 - F. Existing district procedures, relating to collection of funds, are not fully implemented at the school level. The schools are not complying with the district's existing procedures relating to collection of funds.

We recommend that the district establish written policies and procedures through the implementation of "Accounting Procedures for Student Organizations, State Publication No. 3." Furthermore, it is our recommendation that a representative of the district's business office periodically review the student body records to insure compliance to these adopted procedures.

2. Section 10703 of the Educational Code of California requires that each student body fund expenditure be approved by "an employee or official of the school district designated by the governing board, the certificated employee who is the designated advisor of the particular student body organization, and a representative of the particular student body organization." Present procedures do not include approval by the student body advisor or a representative of the student body.

We recommend that all student body expenditures be approved in writing by the student council and student body advisor. Their approval of each expenditure should be included in the minutes of the student council meetings.

3. Student body funds have been expended for instructional supplies and to pay for purchases made on behalf of other groups without written approval from the student council. It is our understanding that the funds expended for instructional supplies were earned by fund-raising drives of groups not involving students and therefore can be expended without student council approval. The above indicates a co-mingling of student body funds with non-student body funds. Co-mingling of funds greatly impairs internal control over student body assets because it allows expenditures from the student body account to be made without student council approval.

We recommend that separate records be maintained to account for the cash transactions of each school-affiliated organization such as student body, parent-faculty, etc.

In addition, it should be noted that monies raised through the joint efforts of the student body and other school-affiliated organizations are considered as student body funds.